REORGANIZATION—THE NEXT STEP

The recent commodity deflation has led to many insolvencies; many reorganizations are under way; many more will be undertaken as a part of post-war readjustment. The banker's problem is to find new money for such reorganization; the lawyer's, to set up a legally valid plan whereunder that new money shall be given not only stock but a prior lien as well, for such investments must in these times be made attractive, indeed. Those who have studied these questions have almost to a man, I believe, accepted as inescapable rules, both of practice and of law, that new money cannot be given a prior lien without the consent of the creditors, both secured and unsecured, and that non-assenting creditors must be paid the cash value of their claims, as the same may be fixed by the court. Compositions in bankruptcy theoretically offer a way in which the will of a majority of unsecured creditors may be imposed upon a dissenting minority but the Bankruptcy Act is of little practical service, since large reorganizations deal not only with secured as well as unsecured creditors, but also with the issue, readjustment and scaling down of stock. The bankruptcy court, so far as the decisions go, has not sufficient power to deal with these problems, nor can it give to new money a lien prior to existing claims.

Are these two rules, limiting the creation of prior liens and compelling a cash payment to non-assentors, actually controlling or is there within the constitutional limitations of our jurisprudence an escape from them? Is an escape desirable? These are the questions to be discussed.

In two articles[1] on the subject of corporate reorganization published in the COLUMBIA LAW REVIEW, I endeavored to point out the ever-broadening jurisdiction of the federal court, but conceded that it is subject to these two rules or limitations. The views there announced have not, so far as I know, been challenged. Upon a further study of that *cause celèbre, Northern Pacific Railway Co.* v. *Boyd*,[2] I now question my own earlier views. The *Boyd* case was received by the reorganization bar and bankers with something akin to horror. It has been a nightmare to the lawyer who presents a decree for the sale of property to a reorganization committee. His fear has been that at some later date a court will hold the sale to have been merely a "step in reorganization" and that creditors will then be able to levy on the property in the hands of the new company. The *Boyd* case, far from occasioning such fears, provides, I believe, if rightly read, a weapon for construc-

[1] *A New Scheme of Reorganization* (1917) 17 COLUMBIA LAW REV. 523; *The Aetna Explosives Case—A Milestone in Reorganization* (1920) 20 COLUMBIA LAW REV. 733.

[2] (1913) 228 U. S. 482, 33 Sup. Ct. 534

tive reorganizations. Its language indicates an economic conception by the Supreme Court of reorganization needs and of the jurisdiction of the federal courts to supply those needs far in advance of the views generally held. If its tenor and import are fully to be followed, these two rules—the stumbling blocks of many reorganizations—would seem to be of the past. The *Boyd* case at least affords encouragement for the belief that any reorganization plan which gives due recognition to security holders in the order of priority of their respective holdings, may be approved and adopted by the court and that dissenting parties would have no recourse if they refused to accept the securities offered them under such a plan. What is it in the *Boyd* case which justifies these broad statements?

To review the facts so far as material, Boyd was a judgment creditor of the Coeur D'Alene Company. The Northern Pacific *Railroad,* as a result of dealings with the Coeur D'Alene Company, subsequently held to amount to a wrongful diversion of the proceeds of the bonds of the company by the *Railroad,* became liable in equity to Boyd as a judgment creditor of the company. The property of the *Railroad* had been sold under foreclosure to the newly created *Railway* company, in pursuance of a reorganization plan subscribed to by the bondholders and stockholders of the old company. Boyd, as a general creditor, not having been a party to the foreclosure, claimed that the property of the old company in the hands of the new was subject to the payment of his debt. In sustaining Boyd's claim, Mr. Justice Lamar said: [3]

"Corporations, insolvent or financially embarrassed, often find it necessary to scale their debts and readjust stock issues with an agreement to conduct the same business with the same property under a reorganization. This may be done in pursuance of a private contract between bondholders and stockholders. And though the corporate property is thereby transferred to a new company, having the same shareholders, the transaction would be binding between the parties. But, of course, such a transfer by stockholders from themselves to themselves, cannot defeat the claim of a non-assenting creditor. As against him the sale is void in equity, regardless of the motive with which it was made. For if such contract reorganization was consummated in good faith and in ignorance of the existence of the creditor, yet when he appeared and established his debt, the subordinate interest of the old stockholders would still be subject to his claim in the hands of the reorganized company. Cf. *San Francisco & N. P. R. R.* v. *Bee,* 48 Cal. 398; *Grenell* v. *Detroit Gas Co.,* 112 Mich. 70. There is no difference in principle if the contract of reorganization, instead of being effectuated by private sale, is consummated by a master's deed under a consent decree."

After holding this to be the result, whether or not the agreement between the bondholders and stockholders was fraudulent, the court proceeded: [4]

"Any arrangement of the parties by which the subordinate rights

[3] *Ibid.* 502. [4] *Ibid.* 505.

and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors, comes within judicial denunciation." And further: [5] "As between the parties and the public generally, the sale was valid. As against creditors, it was a mere form. Though the Northern Pacific Railroad was divested of the legal title, the old stockholders were still owners of the same railroad, encumbered by the same debts. The circumlocution did not better their title against Boyd as a non-assenting creditor. They had changed the name but not the relation. The property in the hands of the former owners, under a new character, was as much subject to any existing liability as that of a defendant who buys his own property at a tax sale."

It is this portion of the opinion that has made the *Boyd* case so unpopular. For these words have generally been interpreted as meaning that if the stockholders are not frozen out, but are allowed to retain an interest in the new company (even if only upon the payment of new money) the creditors must be paid in order to make the reorganized company creditor-proof. The late Francis Lynde Stetson, counsel for the railway, had argued that recognition of Boyd's claim would mean the adoption of a principle requiring payment of cash to creditors and that such a principle would prevent the possibility of reorganization. Said he: "The reorganization of insolvent railroad properties would be an impossibility if honest reasonable plans such as these were to be condemned, and in fact this Court never has condemned them." [6] This argument was considered by the Supreme Court and the following conclusion was reached—a conclusion in which lies the key-note of the present discussion: [7]

This conclusion does not, as claimed, require the impossible and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock. If he declines a fair offer he is left to protect himself as any other creditor of a judgment debtor, and, having refused to come into a just reorganization, could not thereafter be heard in a court of equity to attack it. If, however, no such tender was made and kept good he retains the right to subject the interest of the old stockholders in the property to the payment of his debt. If their interest is valueless, he gets nothing. If it be valuable, he merely subjects that which the law had originally and continuously made liable for the payment of corporate liabilities."

This is sheer dictum, judge-made law, comparable to the receiver's certificate doctrine and to the so-called "six months rule." In the words just quoted the court went out of its way to point out that it did not mean to prevent, but rather to encourage reorganizations. If these words are to be given effect, full provision can be made for unsecured creditors by offering them income bonds or preferred stock on a basis found fair by the court. If the creditors do not choose to accept these securities, they are relegated to the position of a judgment creditor of the defendant

[5] *Ibid.* 506, 507. [6] *Ibid.* 494. [7] *Ibid.* 508 (author's italics).

company without right to resort to the new company which, as a part of the reorganization, takes over the property. If the new company tenders securities deemed fair by the court and keeps good its tender, it receives a good and secure title to the property. The creditor who does not like his preferred stock or his income bond has the empty relief of a worthless judgment against the old company.

If the unsecured creditor may be relegated to the position of a holder of income bonds—the worst known form of security ever devised—or to that of stockholder, it follows that new money which salvages the property and makes the entire reorganization possible may be given a lien prior to that of the old unsecured creditor,[8] for the new company can mortgage its property by complying with the laws of the state of its incorporation. Thus, it seems that despite prevailing practice to the contrary we are freed so far as the unsecured creditors are concerned from the bogey of the non-assenting creditor and from the difficulty of making reorganized companies a sufficiently attractive investment for new money.

We come now to the secured creditor. Can new money be given priority over the mortgage bondholders? In the *Boyd* case this question was not before the court. It may seriously be argued, however, that secured creditors can also be dealt with in the manner approved by the *Boyd* case; that if notice be given and if a majority assent, new money may be given a prior lien despite the objection of the dissenting minority. Questions of due process, of the destruction of vested rights, are immediately presented. But such questions arise also in connection with the claims of unsecured creditors. An unsecured creditor who holds a mere promise, who holds a debenture, or promissory note, owns "property" as sacred as is that of a secured creditor. A contract is property. A *chose in action* is property. A promissory note is property.[9] This property right carries with it a vested constitutional right to bring suit, to get judgment and to issue execution against the debtor's entire assets. Yet these property rights of the unsecured creditor have been brushed aside in the equity receivership suit.[10] To enjoin him from action, from putting his claim into judgment and from issuing execution are matters of common daily practice. He has been compelled to take his distributive share as fixed by the court; and this share according to the *Boyd* case may be either in income bonds or preferred stock. If

[8] While it may be going far afield to refer to the salvage cases in admiralty, they offer an interesting analogy. See *The Dredge No. 1* (D. C. 1905) 137 Fed. 110; *Great Lakes Towing Co.* v. *St. Joseph-Chicago S. S. Co.* (C. C. A. 1918) 253 Fed. 635, *certiorari* denied (1918) 248 U. S. 578, 39 Sup. Ct. 20, and (1919) 249 U. S. 609, 39 Sup. Ct. 290; *The Launberga* (D. C. 1907) 154 Fed. 959, 968.

[9] See *Pritchard* v. *Norton* (1882) 106 U. S. 124, 132, 1 Sup. Ct. 102, (contract); *Hein* v. *Davidson* (1884) 96 N. Y. 175, 177; *Town of Walton* v. *Adair* (1904) 96 App. Div. 75, 80, 89 N. Y. Supp. 230, 234; *Seaman* v. *Clarke* (1901) 60 App. Div. 416, 420, 69 N. Y. Supp. 1002, 1004 (*chose in action*); *Crampton* v. *Newton's Est.* (1903) 132 Mich. 149, 93 N. W. 250 (note).

[10] *Re Metropolitan Railway Receivership* (1908) 208 U. S. 90, 28 Sup. Ct. 219.

such property rights may so be treated, why should not secured creditors be subordinated to the new money which makes a reorganization possible, and which in fact preserves the very rights of the secured creditor? This is doubtless to run counter to traditional views.[11] What are the constitutional limitations, if any, upon such action by an agency of the federal government?

In the famous case of *Canada Southern Railway* v. *Gebhard*,[12] it was squarely held that the federal government could constitutionally enact legislation similar to that in Great Britain, whereunder minority interests are obliged to accept securities in a reorganized company when the plan of reorganization is approved by the court. It is clear that such legislation would not be invalid as a law impairing the obligation of contracts since that constitutional inhibition[13] is directed against the states only, not against the federal government in any of its functions, legislative, judicial or executive.[14] Thus a bankruptcy statute though impairing contract rights is none the less constitutional,[15] and compositions in bankruptcy, though requiring dissenting minorities to accept in discharge of their claims money, or even notes, for less than par can legally be accomplished.[16] The due process clause of the Fifth Amendment contains the crux of the question, since this limitation voids confiscatory acts by any branch of the federal government.[17]

Faced with the problem of due process the court in the *Gebhard* case said:[18]

"Hence it seems to be eminently proper that where the legislative power exists some statutory provision should be made for binding the minority in a reasonable way by the will of the majority; and unless, as is the case in the *States* of the United States, the passage of laws impairing the obligation of contracts is forbidden, we see no good reason why such provision may not be made in respect to existing as well as prospective obligations. The nature of securities of this class is such that the right of legislative supervision for the good of all, unless restrained by some constitutional prohibition, seems almost necessarily to form one of their ingredients, and when insolvency is threatened, and the interests of the public, as well as creditors, are imperilled by the financial embarrassments of the corporation, a reasonable 'scheme of arrangement' may, in our opinion, as well be legalized as an ordinary 'composition in bankruptcy.'

[11] See *Kneeland* v. *American Loan Co.* (1890) 136 U. S. 89, 97, 10 Sup. Ct. 953; *Guaranty Trust Co.* v. *Chicago Union Traction Co.* (C. C. 1907) 158 Fed. 913, 922; *Merchants Loan & Trust Co.* v. *Chicago Rys. Co.* (C. C. A. 1907) 158 Fed. 923.

[12] (1883) 109 U. S. 527, 3 Sup. Ct. 363.

[13] Art. I, Sec. 10, cl. 1.

[14] *Gilfillan* v. *Union Canal Co.* (1883) 109 U. S. 401, 3 Sup. Ct. 304.

[15] This principle was firmly fixed by Chief Justice Marshall in *Sturgis* v. *Crowinshield* (1819) 17 U. S. 122 and was formally reiterated in the *Gebhard* case, *supra*, footnote 12.

[16] *In re Kinnane Co.* (D. C. 1914) 33 Am. B. R. 243; *In re McNab & H. Mfg. Co.* (D. C. 1878) 16 Fed. Cas. No. 8906.

[17] *Murray's Lessee* v. *Hoboken Land & Imp. Co.* (1855) 59 U. S. 272, 276.

[18] *Supra*, footnote 12. pp. 535, 536.

"The confirmation and legalization of 'a scheme of arrangement' under such circumstances is no more than is done in bankruptcy when a 'composition' agreement with the bankrupt debtor, if assented to by the required majority of creditors, is made binding on the non-assenting minority. In no just sense do such governmental regulations deprive a person of his property without due process of law. They simply require each individual to so conduct himself for the general good as not unnecessarily to injure another. . . . The Constitution expressly empowers the Congress of the United States to establish such laws. Every member of a political community must necessarily part with some of the rights which, as an individual, not affected by his relation to others, he might have retained."

An elaborate discussion of the words "due process of law" would be unsatisfactory and useless. The Supreme Court in its wisdom has at all times refused to define the meaning of the clause generically[19] and the inherent reason for such a position cannot be better indicated than by a quotation from an article by that learned jurist, Hon. Charles M. Hough, wherein, after an examination of the growth of the conception of the words "due process," he concludes:[20]

". . . the highest court and most high courts have refused to regard constitutions as codes, and of late years have more and more made due process of law whatever process seems due to the demands of the times, as understood by the judges of the time being."

Nor is Judge Hough alone in this view. In a recent number of the COLUMBIA LAW REVIEW[21] there appeared a valuable discussion by Mr. John B. Cheadle, on the constitutionality of *Government Control of Business.* After pointing out the extent to which the police power has been employed despite the due process clause in such cases as *Munn* v. *Illinois,*[22] *Tanner* v. *Little,*[23] *Pierce Oil Corp.* v. *City of Hope,*[24] *Noble State Bank* v. *Haskell,*[25] he concludes that:[26]

[19] See *Davidson* v. *New Orleans* (1877) 96 U. S. 97, 104; *Holden* v. *Hardy* (1898) 169 U. S. 366, 389, 18 Sup. Ct. 383; *Orient Co.* v. *Daggs* (1899) 172 U. S. 557, 563, 19 Sup. Ct. 281.

[20] *Due Process of Law—Today* (1919) 32 Harvard Law Rev. 218, 233.

[21] (1920) 20 COLUMBIA LAW REV. 550, 558.

[22] (1876) 94 U. S. 113, 125, per Mr. Justice Waite: "Under these [the police] powers the government regulates the conduct of its citizens one toward another, and the manner in which each shall use his own property, when such regulation becomes necessary for the public good. . . . Property does become clothed with a public interest when used in a manner to make it of public consequence and affect the community at large."

[23] (1916) 240 U. S. 369, 386, 36 Sup. Ct. 379 where the court said: "The Police power is not subject to any definite limitations, but is coextensive with the necessities of the case and the safeguard of the public interests."

[24] (1919) 248 U. S. 498, 500, 39 Sup. Ct. 172: ". . . [the right to exercise the police power] 'is a continuing one, and a business lawful today may in the future, because of the changed situation, the growth of population or other causes, become a menace to the public health and welfare, and be required to yield to the public good.'"

[25] (1911) 219 U. S. 104. 111. 31 Sup. Ct. 186. Mr. Justice Holmes said: "It [the police power] may be put forth in aid of what is sanctioned by usage, or held by the prevailing morality or strong and preponderent opinion to be greatly and immediately necessary to the public welfare."

[26] *Supra,* footnote 21, p. 559.

"It would seem, then, that under our constitutions the legislature should be free to adopt any policy, or act upon any principle of conduct not clearly opposed to the trend of public thought and the needs of society, and not arbitrary or personal in its intent or effect upon any individual." And more definitely as a conclusion:[27] ". . . that the legislative body may go so far in the way of business regulation as the needs of society may demand and the opinions of society warrant."

What are the demands of the time, what the violent period of deflation and readjustment in our commerce demands, needs no explanation. The understanding of the judges of the time being is surely set forth in plain terms in the *Boyd* case.

The *Gebhard* case and those discussed by Mr. Cheadle all tend to establish the constitutionality of *legislation* enacting the desired result. These cases, however, still leave open the interesting question whether a federal court of equity, without specific legislative authority, might nevertheless proceed as suggested in the administration of corporate reorganizations before it. While the *Gebhard* case says that there is nothing to prevent such legislation, it does *not* say that *legislation is necessary* to accomplish the result. And the *Boyd* case indicates clearly that such legislation is, in the opinion of the Supreme Court, *not* necessary. Nor does its express language treat only of unsecured creditors for in its statement quoted above—that "any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of *either* class of creditors comes within judicial denunciation"—the *Boyd* case implies that it is dealing with both classes of creditors, the secured as well as the unsecured. What would be due process if done by the legislature would therefore seem to be due process if done by the courts, and the acts of the federal courts are no more curtailed by the "impairment of contract obligation" clause than is the federal Congress.[28] It is only through such reasoning that that important branch of jurisprudence "judge made law" is justified. The question thus becomes one of the inherent power of the federal court of equity. Let us therefore review very briefly the growth and extension of that power over financially embarrassed corporations as conceived by various courts.

In 1890 the Supreme Court in *Kneeland* v. *The American Loan Co.* expressed the following narrow view:[29]

" . . . the appointment of a receiver vests in the court no absolute control over the property, and no general authority to displace vested contract liens. Because in a few specified and limited cases this court has declared that unsecured claims were entitled to priority over mortgage debts, an idea seems to have obtained that a court appointing a

[27] *Ibid.* 579.
[28] *Gilfillan* v. *Union Canal Co., supra,* footnote 14.
[29] (1890) 136 U. S. 89, 97, 10 Sup. Ct. 950.

receiver acquires power to give such preference to any general and unsecured claims."

Only eighteen years ago in the *New York City Railway Co.* receivership, Judge Lacombe, in an unreported opinion, said:

> "In this Circuit it is not the practice for receivers to concern themselves with plans of reorganization. . . . Their sole functions are to hold the property intact, operating it as efficiently for the public service as their resources will permit; to ascertain the liabilities; to marshall the assets and eventually to sell to the best advantage."

Contrast with such expressions the opinion in the following cases which may fairly be stated to represent the present day view of the federal courts' equity power.

Judge William C. Hook of the United States Circuit Court for the Eighth Circuit, sitting in the case of the *Guaranty Trust Company* v. *Missouri Pacific Railroad,* said:[30]

> "It has sometimes been claimed that plans of reorganization formulated by bondholders and stockholders of a railroad in the hands of receivers are exclusively of private concern, free from judicial action or interference. But for various reasons the view cannot be sustained in principle. After all that can be said from the standpoint of theory and strict right, the fact remains that many railroad receiverships, and the one here is typical of them, are but instruments for consummating plans of reorganization, and courts have come to realize that such use of their jurisdiction and processes entails a correlative duty to those affected by the result. . . . The conclusion is manifest that the general duty of a court in a railroad foreclosure suit to take cognizance of a plan of reorganization by the bondholders and stockholders which is to be aided by its decree, and to protect the equitable rights of all, becomes specific and imperative upon the complaint of an interested party."

And three years ago Judge Martin T. Manton of the Circuit Court of Appeals for the Second Circuit, sitting in the case of the insolvency of an industrial company, *Graselli Chemical Co.* v *Aetna Explosives Co.*,[31] held that since the *res* (the corporate property) was in the court's custody the district judge had been within his power in enjoining the holding of an annual meeting, saying, "a court of equity's modes of relief are not fixed and rigid"; that "it can mould its remedies to meet the conditions with which it has to deal"; that the "jurisdiction of equity is the whole domain of conscience, limited only by legislative enactment"; and that "the faculty of equity must be energetic, productive and progressive." Starting with this point of view he proceeded to examine a reorganization plan *in extenso* and having analyzed it, concluded that it was unfair and declared flatly that the district judge had the power to inquire "into the merits of the plan of readjustment," and sustained the granting of the injunction by the District Court not only because the

[30] (D. C. 1916) 238 Fed. 812, 815.
[31] (C. C. A. 1918) 252 Fed. 456.

res was in the court's control, but on the express ground that the plan for taking that *res* out of the court's hands was inequitable.

A pithy summary of the situation is contained in the opinion of Judge Walter C. Noyes in the *New York City Railways* case,[32] where, after pointing out how suits of this character have "broadened in scope," and after indicating the constant increase of power exerted by the courts, he concluded by saying: "Thus is illustrated anew the vainness of saying what Courts of equity *cannot* do." And even in 1899, before Judge Lacombe's opinion in the *New York City Railways* receivership previously referred to, Judge Lurton, then of the Circuit Court of Appeals, declared [33] that in cases of this type the court possessed "full, complete and exclusive jurisdiction and power to deal with the property of that company, and *with all interests in it and with all controversies respecting it.*"

If the court has such extensive powers over a corporate reorganization before it, if its jurisdiction is the whole domain of economic needs limited only by express legislative enactment, if it can, at the institution of a creditor at large, take hold of an insolvent defendant, administer its business and enjoin all interference,[34] if it can issue receiver's certificates having priority in all cases over unsecured creditors, and in cases involving what is termed "public interest" even over the secured creditors,[35] if it can under the so-called "six months rule" [36] require a prior payment of a general indebtedness incurred in the mere operation of a public utility, despite the existence of a previous mortgage and of the vested rights of bondholders thereunder,[37] if it exercises all these powers without express statutory authority, it does not seem to be stretching equitable principles and jurisdiction beyond their reasonable intentions to give new money priority over secured creditors upon the consent of a majority, after complying with what may be called the essentials of due process, in giving notice and a "day in court" to the dissenters,[38]

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[32] *Pennsylvania Steel Co.* v. *New York City Ry. Co.* (C. C. A. 1912) 198 Fed. 721, 737.

[33] *Toledo, etc. R. Co.* v. *Continental Trust Co.* (C. C. A. 1899) 95 Fed. 497, 504 (author's italics).

[34] *Re Metropolitan Railway Receivership, supra*, footnote 10.

[35] *Union Trust Co.* v. *Illinois Midland Ry. Co.* (1886) 117 U. S. 434, 6 Sup. Ct. 809; *Smith* v. *Shenandoah Nat'l Bk.* (C. C. A. 1917) 246 Fed. 379; *American Brake S. & F. Co.* v. *Pere Marquette R. Co.* (C. C. A. 1913) 205 Fed. 14; *Central Trust Co.* v. *Pittsburg S. & N. R. R. Co.* (1918) 223 N. Y. 347, 116 N. E. 1040. *Cf.* Cheadle, *op. cit.* 566: "But, even granted that we have the two classes, public and private business, as applicable to those who deal with the public, yet, since we find that the dividing of the classes may vary from one century to another, it is little more than a matter of nomenclature that is settled; it amounts to this, that we reserve the term "public calling" for such callings as the law sees fit to put under affirmative regulations and retain the name private for other businesses."

[36] See 1 Smith, *Receivers* (Tardy's ed. 1920) § 418, p. 1163, for the limitations of this doctrine.

[37] See *Fosdick* v. *Schall* (1878) 99 U. S. 235; *Southern Ry. Co.* v. *Carnegie Steel Co.* (1900) 176 U. S. 257, 20 Sup. Ct. 347; *Gregg* v. *Metropolitan Trust Co.* (1905) 197 U. S. 183, 25 Sup. Ct. 415; and a fine discussion in 1 Smith, *op. cit.* §§ 412-429, pp. 1139-1216.

[38] *Cf. Ochoa* v. *Hernandez y Morales* (1913) 230 U. S. 139, 161, 33 Sup. Ct.

and by giving to secured creditors a lien on the property, junior only to the new money but maintaining a proper rank as to all other claims. This is not to deprive the mortgage creditor of his security, but merely to subordinate him to new moneys which, as a matter of fact, salvaged and saved that very security. Such a power in the federal courts would be, according to Mr. Chief Justice Waite in *Stone* v. *Farmers Loan & Trust Company*,[39] one rather of regulation than of confiscation. While there are no reported opinions giving the courts such power, that course was taken in at least three cases of some importance. In the *Rock Island* case,[40] an able discussion of which appears in an article[41] by Mr. Roberts Walker of this bar, Judge George A. Carpenter concluded that he could accomplish directly by a decree that which he could accomplish indirectly by a sale, to wit: the ascertainment of a cash value for the general creditors. He further decided that he had the power to fix that value in new stock. A decree to that effect was entered and no alternative cash provision for creditors was made. Again, in *Re Bijur Motor Lighting Co.*,[42] an industrial corporation, Judge Martin T. Manton signed a decree whereunder all creditors were obliged to accept ten year debentures, no upset price in cash being fixed for the non-assentors. In the very recent Chicago and Eastern Illinois Railroad reorganization,[43] a plan having been formulated, the reorganization committee petitioned the court in the receivership cause to fix a date for the hearing of complaints as to the fairness of offers made pursuant to the plan. On that date, one creditor, a bank, objected. Whereupon Judge Carpenter entered a decree to the effect that all parties, having had the opportunity to dissent from or assent to the plan, "all persons and corporations except said bank are forever barred from making any complaint as to said Plan and Agreement and said Offers, and each of them." No cash provision seems to have been made for non-assentors. While none of these cases involved the problem of the secured creditor and while no non-assentors questioned the power of the court so to act, the actual substitution by court decree, of obligations of the reorganized company in settlement of the claim of unsecured creditors, indicates that this discussion is by

1033; *Twining* v. *New Jersey* (1908) 211 U. S. 78, 111, 29 Sup. Ct. 14, 24; *Illinois T. & S. Bk.* v. *Des Moines* (D. C. 1915) 224 Fed. 620, 622; *Consolidated Gas Co.* v. *Mayer* (C. C. 1906) 146 Fed. 150, 152; *Pearson* v. *Yewdall* (1877) 95 U. S. 294, 296.

[39] (1886) 116 U. S. 307, 331. "This power to regulate is not a power to destroy, and limitation is not the equivalent of confiscation."

[40] *American Steel Foundries* v. *The Chicago, Rock Island & Pac. Ry. Co.*; *Bankers Trust Co., as Trustee* v. *Same* (D. C. N. D. Ill., E. Div., June 12, 1917) Cons. Cause Eq. No. 445 (not reported).

[41] (1921) 6 Cornell Law Quart. 154, 162.

[42] Not reported. Judge Martin T. Manton of the Circuit Court of Appeals for the Second Circuit sitting in the District Court.

[43] *Railway Steel-Spring Co.*; *Bankers Trust Co., Trustee*; *Metropolitan Trust Co. of the City of New York, Trustee*; *Central Trust Co. of New York, Trustee*; *The Farmers Loan and Trust Co., Trustee*, complainants v. *Chicago and Eastern Illinois Railroad Co.* et al., defendants (D. C., N. D. Ill., E. Div., May 3, 1921). Cons. Cause Eq. No. 57 (not reported.)

no means in the realm of the merely academic. It is, at least, the fact that since the *Boyd* case, reorganization decrees have contained provisions making express reference to the plan of reorganization and adjudging it to be fair. While in some or perhaps practically all of such decrees a cash price for non-assenting creditors has been fixed, it seems but one more step to make no such provision.

Just as the power of the legislature must be appropriate to meet the needs of the time, so likewise must the power of the courts. The federal courts, always in favor of reorganizations,[44] are therefore steadily extending their control over the affairs of insolvents. Their justification, if one indeed be needed, is announced in the *Aetna* case:[45]

"In the absence of power created by Legislation in this country, the federal judges, sitting in courts of equity, have endeavored to secure to the rights of those interested, including the stockholders at the time of readjustment of large corporations a protection to meet the needs of the occasion. Changing times, with change in economic needs, require the courts of equity to mold remedies to meet the conditions with which they have to deal."

It is a fact that in some earlier decisions contrary language may be found,[46] but the latest of these was in 1907. A great deal of judicial water has run under the bridge since then and the channel of equity has undoubtedly become a broader one. The strongest expression in these cases of the old fashioned legalistic doctrine of the inviolability of vested rights was specifically based upon the premise that "the appointment of a receiver vests in the court no absolute control over the property."[47] That this premise announced in 1890 is no longer sound and that therefore its conclusion is unsustainable, has been sufficiently indicated in the foregoing outline of the broadened scope of equity's powers.

Has the Supreme Court moreover ever been deterred by the cry of vested interests in the face of economic needs? The *Slaughter House Cases*,[48] the *Sinking Fund Cases*,[49] the *Hurtado* case,[50] and the more recent cases involving wages and hours of labor,[51] blue-sky laws,[52] employment agency licenses[53] and the rent legislation give answer. The

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[44] *Guaranty Trust Co.* v. *Missouri Pac. R. R.* (D. C. 1916) 238 Fed. 812, 815; *Louisville Trust Co.* v. *Louisville etc. Ry.* (1899) 174 U. S. 674, 19 Sup. Ct. 827; *Graselli Chem. Co.* v. *Aetna Explosives Co.* (C. C. A. 1918) 252 Fed. 456.

[45] *Supra*, footnote 44, p. 460, *per* Judge Manton.

[46] *Supra*, footnote 11.

[47] *Kneeland* v. *American Loan Co.*, *supra*, footnote 11, p. 97.

[48] (U. S. 1872) 16 Wall. 36.

[49] (1878) 99 U. S. 700.

[50] *Hurtado* v. *California* (1884) 110 U. S. 516, 4 Sup. Ct. 111.

[51] *Wilson* v. *New* (1917) 243 U. S. 332, 37 Sup. Ct. 298; *Muller* v. *Oregon* (1908) 208 U. S. 412, 28 Sup. Ct. 324; (*semble*) *contra*, but commonly distinguished, *Lochner* v. *New York* (1905) 198 U. S. 45, 25 Sup. Ct. 539, Justices Harlan, White, Day and Holmes dissenting.

[52] *Hall* v. *Geiger-Jones Co.* (1917) 242 U. S. 539, 37 Sup. Ct. 217.

[53] *Brazee* v. *Michigan* (1916) 241 U. S. 340, 36 Sup. Ct. 561; *contra*, *Adams*

welfare of the greatest number must and ultimately does always overcome the individualist's fervent wail for the protection of his own property. The purchaser of securities in the large corporations of this country, railroads, public utilities and industrials, buys into enterprises in which the public has a deep interest. He cannot elect to play the role of the mortgagee in the melodrama foreclosing on the old homestead. The receiver's certificate cases go a long way toward proving this, and though the courts have yet to extend that doctrine to industrial corporations, it is believed that it needs only the receivership of a large industrial in which there is an undoubted public interest to induce the courts to extend that doctrine. The previously mentioned "six months rule" [54] offers a close analogy as to the power of courts without the aid of legislation to "make" law when the occasion demands it. This rule, first formally announced in the case of *Fosdick* v. *Schall* [55] under which expenses incurred in continuing the operation of a public utility are given priority over mortgage secured creditors, is pure "judge made" law. It calls to mind a recent remark of a reorganization lawyer who said that he was trying to draw a mortgage which would give the bondholders as good a position as that of the unsecured creditors.

A few concluding observations on the subject of due process may perhaps be best put in the form of questions. The cases in which the due process clause has come before the courts are those in which somebody claims that a legislative act has deprived him of something. To whom shall that somebody complain? Only to a court. And if it be a court decree of which he complains as confiscatory, shall he complain to the legislature or to an executive? His only remedy is by appeal, which finally lands him in that very court which handed down the *Boyd* decision.

If the economic background of the arguments here made is incorrectly pictured, then the legal arguments will fall—and should fall. But if in this industrial country the will of the majority may be heard, minorities if fairly treated, should not, it is believed, be permitted to adopt obstructive tactics in the assertion of nuisance value. The dictum in the *Boyd* case which is the foundation of this discussion was "judge made" law. The Supreme Court went out of its way to make that law. Why did that not too impulsive tribunal do so unless because it saw that the time has come for the federal court to require all security holders to submit to a plan approved by majorities of the various classes and found fair by the court? Not to do so is to subject the majority to the will of the minority, since as a practical matter if twenty-five or thirty per cent of the respective groups of creditors refuse to enter into a reorganization, and if it becomes necessary to pay them the cash value of their

v. *Tanner* (1917) 244 U. S. 590, 37 Sup. Ct. 662, by the well known five-to-four vote, Justices McKenna, Brandeis, Holmes and Clarke dissenting.

[54] *Supra,* footnotes 36, 37.

[55] *Supra,* footnote 37.

claims, so large an amount of money would be required as to result not infrequently in the entire defeat of a constructive plan for reorganizing a corporation, saving its business, its creditors, stockholders and so serving the public interest as well.

What then becomes of that sacrosanct proceeding, the foreclosure which takes place so frequently as a part of reorganization? Sacrosanct? It is a matter of practice merely. If a sale is but a "step in reorganization," why not bury the foreclosure among the ancient relics of outworn practice? Why not a sale free of liens as in bankruptcy practice? The safeguards of foreclosure were not intended for the benefit of creditors, but for the protection of the holder of the equity of redemption. Forward-looking lawyers have torn down many exacting structures of technique. Trover, writs of disseizin, enfeoffment, confession and avoidance, rejoinder and surrejoinder—the very words are strange to the modern lawyer's ears. As technique in art is but the servant of beauty, so technique, practice, procedure in the law are but the handmaids of Justice—otherwise the law becomes a vain and empty ritual. If foreclosure practice is not an aid, but an obstacle to reorganization, why not then substitute an offer to the court by the reorganization committee to take over the property of the old company free of liens, the new securities to be issued to the old creditors and stockholders pursuant to the plan? This is but to carry out the implications of the *Boyd* case.

With such an application of that decision in actual practice, a possible solution, at least, of still another reorganization problem offers itself. When the capitalization of the reorganized company is subject to the supervision of state or federal commissions, the reorganizers under prevailing practice find themselves in a dilemma. A small upset price—desirable, often necessary, to avoid the payment to the non-assentors of a prohibitively large sum in cash which the reorganizers cannot afford—results in difficulty in gaining the approval of the commission to a capitalization substantially larger than the upset price, even though the court has approved the plan. While it is true that if the acts of an agency of a state amount to confiscation, the federal court may override them—as recently reiterated by the United States Supreme Court in *Bullock* v. *Florida*[56]—such a troublesome conflict is avoided if we are freed from the bogey of the non-assentor and his cash payment and of the consequent necessity of a small upset price. Although the capitalization approved by the court will not necessarily be adopted by a commission, the obstacle of the low price as a standard of value for the commission is overcome and a long step is made toward persuading the commission of the justice of the plan approved by the court.

In short, once the bench and the bar act on the theory of the *Boyd* case, the troublesome question of upset price, the waste of effort in se-

[56] (1921) 254 U. S. 513, 41 Sup. Ct. 193.

curing practically unanimous approval of a plan, the months of delay in gaining the assent of the last twenty or twenty-five per cent are obviated. The fact that the plan is not that of one dominating group but of a disinterested court aids in securing prompt acquiescence. Obstructive minorities lose their vantage ground; tyrannical majorities are controlled by the court.

It is readily acknowledged that the entire subject presents novel and highly debatable questions of law and of economic policy. Much is to be said in favor of the precept that "that country is best governed which is least governed." It may well be argued that it is a bad thing to give majorities too great a power over minorities. Many able lawyers would doubtless oppose so great an extension of federal judicial powers as would result from the construction of the *Boyd* case here presented. Yet on the other hand if the minority has its day in court the enforcement upon all interests of a majority plan approved by a disinterested tribunal, seems not only beneficial but in these times almost a *sine qua non* to the rehabilitation of insolvent corporations. Finally, it is hoped that this discussion may at least serve to bring to the front the living problem of the relation of due process to corporate reorganization.

JAMES N. ROSENBERG

NEW YORK CITY